No. 73-_____

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IN THE

Supreme Court of the United States

October Term, 1973

BANGOR PUNTA CORPORATION, NICOLAS M. SALGO AND DAVID W. WALLACE,
Petitioners,

v.

CHRIS-CRAFT INDUSTRIES, INC.,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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July 20, 1973.

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IN THE

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No. 73-_____

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Petitioners,

v.

CHRIS-CRAFT INDUSTRIES, INC.,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners, Bangor Punta Corporation ("BPC"), Nicolas M. Salgo and David W. Wallace, Defendants-Appellees below, pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit which was entered on March 16, 1973 and modified on April 25, 1973.

Opinions Below

The opinions of the District Court for the Southern District of New York are reported at 337 F.Supp. 1128 and 331 F.Supp. 1154 and are reproduced at pp. G-1-38 and C-1-18 of the Joint Appendices ("Jt. App.") hereto. The opinion

of the Second Circuit (Jt. App. H-1-124), has not yet been officially reported.* Prior opinions by the District Court for the Southern District of New York and the Second Circuit *en banc* relating to this action are reported at 303 F.Supp. 191 (Jt. App. A-1-17) and 426 F.2d 569 (Jt. App. B-1-31).

Jurisdiction

The decision of the Second Circuit, reversing the decision of the District Court, was entered on March 16, 1973. On April 25, 1973, the Second Circuit denied timely petitions by all defendants-appellees for rehearing except that it modified its judgment and opinion dated March 16, 1973 in regard to the defendants-appellees Paul L. Miller and Nicholas H. Bayard. This Court's jurisdiction is invoked pursuant to 28 U.S.C. ¶ 1254(1).

Questions Presented

The instant case presents the following three major questions concerning the scope of private actions for money damages under the anti-fraud provisions of the Securities Exchange Act of 1934, as amended ("1934 Act"):

1. Is proof of *scienter* required in private actions for money damages under the anti-fraud provisions of the 1934 Act?

2. Did this Court's prior decisions in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970), and *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972), eliminate as a required element of proof in actions brought by individual

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* The Second Circuit consolidated for purposes of its opinion the appeals by BPC in its action against Chris-Craft Industries, Inc. ("CCI") (Docket No. 72-1120) and in the action commenced by the Securities and Exchange Commission ("SEC") against BPC (Docket No. 72-1140) and the appeal by the SEC in such action (Docket No. 72-1053). BPC is not seeking a review by this Court of the decisions of the Second Circuit in such appeals.

plaintiffs for money damages under the anti-fraud provisions of the 1934 Act, proof that the money damages demanded were in fact caused by the acts of the defendant?

3. Does one offeror in a competitive exchange offer to the shareholders of a target corporation have standing to maintain a cause of action for money damages under Section 14(e) of the 1934 Act against a competing offeror?

Statutes and Regulations Involved

Section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), provides in pertinent part:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Section 14(e) of the 1934 Act, 15 U.S.C. § 78n(e), provides in pertinent part:

> "It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. . . ."

Section 28(a) of the 1934 Act, 15 U.S.C. § 78bb(a), provides in pertinent part:

> "The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. . . ."

Rule 10b-5 under the 1934 Act, 17 C.F.R. § 240.10b-5, provides as follows:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security."

Rule 10b-6 under the 1934 Act, 17 C.F.R. § 240.10b-6, provides in pertinent part:

> "(a) It shall constitute a 'manipulative or deceptive device or contrivance' as used in section 10(b) of the act for any person, . . .
>
> (2) Who is the issuer or other person on whose behalf such a distribution is being made . . .

directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, either alone or with one or more other persons, to bid for or purchase for any account in which he has a beneficial interest, any security which is the subject of such distribution, or any security of the same class and series, or any right to purchase any such security, or to attempt to induce any person to purchase any such security or right, until after he has completed his participation in such distribution: *Provided, however,* that this section shall not prohibit . . . (ii) unsolicited privately negotiated purchases, each involving a substantial amount of such security, effected neither on a securities exchange nor from or through a broker or dealer; . . .

• • •

(b) The distribution of a security (1) which is immediately exchangeable for or convertible into another security, or (2) which entitles the holder thereof immediately to acquire another security, shall be deemed to include a distribution of such other security within the meaning of this section. . . ."

Statement of the Case

This action was commenced in the District Court for the Southern District of New York by CCI on May 22, 1969. The complaint was amended on May 29, 1969 and June 9, 1970. Jurisdiction of the District Court was invoked under 28 U.S.C. § 1331(a), Section 27 of the 1934 Act, 15 U.S.C. § 78aa, and Section 22 of the Securities Act of 1933, as amended ("1933 Act"), 15 U.S.C. § 77v.* The complaint alleged violations of Section 5 of the 1933 Act, 15 U.S.C. § 77e, and Sections 10(b) and 14(e) of the 1934 Act, 15 U.S.C.

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* The dismissal of CCI's claim under the 1933 Act was affirmed by the Second Circuit (Jt. App. H-41-43).

§§ 78j(b) and 78n(e), and Rules 10b-5 and 10b-6, 17 C.F.R. §§ 240.10b-5, 240.10b-6, promulgated thereunder. Named as defendants were BPC and its then entire Board of Directors, Piper Aircraft Corporation ("Piper") and five Piper directors including William, Howard and Thomas Piper,* and the investment banking firm, The First Boston Corporation ("First Boston"), and its president, Paul L. Miller and vice-president, Nicholas H. Bayard.**

On August 19, 1969, the District Court for the Southern District of New York denied a motion by CCI for a preliminary injunction on the grounds that no irreparable injury was established, and that it was unlikely CCI would ultimately sustain its complaint. In effect, the District Court dismissed CCI's complaint (303 F.Supp. 191, Jt. App. A-1-17). CCI took an interlocutory appeal, and, on April 28, 1970, the Court of Appeals for the Second Circuit, *en banc*, in four opinions unanimously affirmed the denial of the preliminary injunction on the grounds that no irreparable injury was established but, with two judges dissenting, reversed the conclusions of law of the District Court, and remanded the case for further proceedings consistent with the majority opinion (426 F.2d 569, Jt. App. B-1-31).

On September 25, 1970, CCI withdrew the claim for equitable relief it had been vigorously pressing until such date and informed the District Court that it sought money damages only. A two week non-jury trial took place between March 9 and March 20, 1971.

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* Of the members of the BPC Board of Directors, only Nicolas M. Salgo, Chairman, and David W. Wallace, President, were served with process. Of the five Piper directors named, only the three Piper brothers were served with process.

** Defendants First Boston and William, Howard and Thomas Piper are also filing petitions seeking writs of certiorari from this Court to review the decision of the Second Circuit as it applies to their specific interests. This Court is respectfully referred to the Petitions of the co-defendants.

On December 10, 1971, the District Court again dismissed the complaint of CCI on the grounds that CCI had failed to prove that any violation of the anti-fraud provisions of the 1934 Act caused its claimed injury, i.e., that it was prevented from obtaining control of Piper in the contest for control waged between CCI and BPC between May 8, 1969 and September 5, 1969 (337 F.Supp. 1128, Jt. App. G-1-38, and 331 F.Supp. 1154, Jt. App. C-1-18). On March 16, 1973, the Second Circuit reversed the District Court, and although all three judges concurred in the result reached against the BPC defendants, there were three separate opinions filed in which each judge arrived at his conclusion by a different route (Jt. App. H-1-124).

This action arose out of the contest between BPC and CCI to acquire control of Piper that took place between May 8, 1969 and early September, 1969, when BPC succeeded in acquiring record ownership of more than 50% of the outstanding Piper shares. CCI had begun its efforts to gain control of Piper in early January, 1969. By February 4, 1969, through open-market purchases and a cash tender offer, CCI had acquired approximately 547,000 Piper shares, or approximately 34% of the outstanding Piper shares. Between February 4 and May 8, 1969, CCI had purchased less than 10,000 additional Piper shares.

On May 8, 1969, BPC acquired 501,090 Piper shares (approximately 31%) from various members of the Piper family, including the defendants William, Howard and Thomas Piper under a written contract. Between May 14, 1969 and May 23, 1969, BPC purchased for cash an additional 120,200 Piper shares from three separate firms in privately negotiated cash transactions off any stock exchange. Commencing on July 18, 1969 and continuing until July 29, 1969, BPC made a registered exchange offer to all Piper shareholders, and obtained approximately 110,000 additional Piper shares. Before, during and after BPC's exchange offer (from May 15, 1969 to August 4, 1969) CCI had made its own registered exchange offer to the Piper

shareholders. When CCI's exchange offer formally closed on August 4, 1969, CCI acquired approximately 112,000 additional Piper shares.

Thus, by August 4, 1969, BPC owned approximately 45% of the Piper shares and CCI owned approximately 41%. Both contestants then proceeded to seek additional Piper shares in the open market. By September 5, 1969, BPC had purchased approximately 100,000 additional Piper shares, while CCI had purchased only approximately 29,000 Piper shares, all between August 12 and August 18. As a result of these open-market purchases, BPC succeeded in obtaining record ownership of more than 50% of all Piper shares.

In summary, the Court below held that: (a) BPC violated Section 14(e) of the 1934 Act by omitting to state a material fact in its registration statement for its exchange offer to the shareholders of Piper; (b) BPC's cash purchases of Piper shares in May, 1969 were in violation of Rule 10b-6; (c) CCI had standing to maintain an action under Section 14(e) for money damages; and (d) CCI was entitled to money damages under Section 14(e) and Rule 10b-6 without proof (i) that BPC had acted in bad faith or with an improper motive or evil intent at any time during the contest for control, or (ii) that the unintentional violations of the anti-fraud provisions of the 1934 Act found to have been committed by BPC, in fact, caused CCI's alleged multi-million dollar damages.

Reasons for Granting the Writ

The decision for which certiorari is sought affords this Court the unique opportunity to give to the federal district courts the guidance necessary to make some order out of the confusion generated by the conflicting views of the courts below of what was intended by Congress when it enacted the federal securities laws. In this case, not only can this Court define who is a proper party to maintain an action under

Section 14(e) of the 1934 Act, but it can authoritatively dispel the direct contradictions found among the Circuits covering the essential elements of proof in actions under the anti-fraud provisions of the 1934 Act. This vital area of the law, which in recent years has given rise to a torrent of litigation and directly affects the lives and fortunes of the business community and the public investors, should not be permitted to drift without the guideposts that can only be furnished by this Court.

If this decision of the Second Circuit is allowed to stand, it will be cited as authority for several revolutionary concepts of law. In addition to being the first major action defining the intended scope of Section 14(e) of the 1934 Act, the decision below will be authority both for the proposition that proof of *scienter* has been eliminated as a required element of proof in all actions based upon the anti-fraud provisions of the 1934 Act, and the proposition that the traditional proof requirement in actions sounding in tort for money damages, that a plaintiff prove "causation in fact" by a preponderance of evidence, is also no longer required in private actions under the anti-fraud provisions of the 1934 Act.

Under the Second Circuit's decision, if a plaintiff in an action under the anti-fraud provisions of the 1934 Act establishes that a fact has been misstated or omitted which a court, necessarily by hindsight, decides is material, then a defendant's lack of knowledge of falsity, intent and absence of bad faith become irrelevant, and further, the plaintiff is not required to prove that his claimed damage was caused by the defendant's violation because causation is presumed as a matter of law once any violation of the 1934 Act is established.

In other words, responsible and honest businessmen are now subject to being held personally liable for claims for huge money damages (in the instant case CCI has claimed damages in excess of $40,000,000, and the individual de-

fendants have been held jointly and severally liable),* without proof that they acted with improper motive, or that their actions *actually caused* the claimed injury.** This is a staggering concept, and will further hasten the departure from the boards of public corporations of the skilled, experienced businessmen who, in their capacity as directors, provide the necessary policy direction to the business of America.

A. The continuing confusion among the Circuits concerning proof requirements for private actions for money damages under the anti-fraud provisions of the 1934 Act requires an authoritative statement from this Court in order that the Bar can reliably advise and counsel their clients.

In each of the three opinions below, the Second Circuit expressly accepted the findings of the District Court that BPC's management was not guilty of any "improper purpose" or "bad faith" and that the BPC registration statement "was unintentionally in error." (Jt. App. C-14, G-19, H-37, 79, 97-100, 117-123). Although Judge Timbers in his opinion alluded to the "reckless" conduct of the BPC management without referring to any evidence in the record at one point (Jt. App. H-48) and then characterized their actions as constituting "negligence" at another (Jt. App. H-56), Judge Mansfield, joined in substance by Judge Gurfein, declared that any claim that the BPC defendants' conduct was "most flagrant" or "reckless" or that they acted in "bad faith" or with an "evil intent", "simply ignore(s) undisputed contrary findings of fact, which are

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* Under the decision of the Second Circuit, every one of the BPC directors would have been held personally liable had they been served with process.

** All three opinions agreed with the District Court that CCI failed to prove that, but for the actions of BPC, it would have obtained control of Piper (Jt. App. H-56, 95-96, 109-111) or that BPC or its management acted in bad faith or with improper motive (Jt. App. H-37, 79, 97-100, 117-123).

fully suported by more than ample credible evidence." (Jt. App. H-97-98, 117-123). The indisputable fact is that the BPC defendants acted in complete good faith and *did not know* the registration statement was misleading.*

Despite the protestations to the contrary contained in the three opinions, the decision below effectively reversed all previous decisions of the Second Circuit, which uniformly required that a plaintiff prove that a defendant acted with an "evil purpose" or knowledge of falsity or in "bad faith", i.e., with *scienter*, before a claim for money damages could be sustained under anti-fraud provisions of the 1934 Act. ** See *Shemtob* v. *Shearson, Hammill & Co.*, 448 F.2d 442, 445 (2d Cir. 1971); *Heit* v. *Weitzen*, 402 F.2d 909, 913-14 (2d Cir. 1968), *cert. denied*, 395 U.S. 903 (1969); and *Globus* v. *Law Research Service, Inc.*, 418 F.2d 1276, 1290-1 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970).

The gap between the accepted findings of fact and the pre-existing standard of proof,*** was bridged by a new stand-

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* Although Rule 10b-6 is a technical trading rule and intent is irrelevant, the BPC defendants were acting upon the advice of their counsel when BPC purchased the Piper shares in May, 1969, and did not know the purchases were improper.

** In their opinions, the three judges could not even agree upon a consistent formulation of the rule prevailing in the Second Circuit. Judge Timbers stated that under prior cases "The scienter requirement in a Rule 10b-5 private damage action appears to have been reduced to a knowledge of falsity or reckless disregard for the truth standard . . ." (Jt. App. H-22). Judge Gurfein stated the standard by reference to the formulation of the *Texas Gulf Sulphur* case where "recklessness that is equivalent to wilful fraud" was held to be required. (Jt. App. H-96). Judge Mansfeld opined that *"some degree of awareness"* must be established. (Emphasis in original). (Jt. App. H-105).

*** Although the liability of the defendants was sustained under Section 14(e) of the 1934 Act, the proof should be identical in actions under Section 10(b) of the 1934 Act and Rule 10b-5 thereunder in regard to the *scienter* requirement. (Jt. App. H-34).

ard of required proof outlined by Judge Mansfield and joined by Judge Timbers (Jt. App. H-36-37):

> "In short, the *scienter* requirement would be met if the corporate officer (1) knew the essential facts and failed to disclose them, or (2) failed or refused, after being put on notice of a possible material failure in disclosure, to apprise himself of the facts under circumstances where he could reasonably have ascertained and disclosed them without any extraordinary effort." (Jt. App. H-106).

In other words, no longer must a plaintiff prove that a defendant knew the information being furnished was false, but only that the defendant knew or should have known the facts.*

The effect of this formulation is to add to the already intolerable confusion on this issue. This confusion has been further exacerbated by the apparent displeasure of other members of the Second Circuit with the standard announced in the opinions below, which emerged in three subsequent decisions discussing the *scienter* requirement filed within weeks of the instant decision.

In *Cohen* v. *Franchard*, CCH Fed. Sec. L. Rep. [Current Binder] ¶ 93,937 (2d Cir. April 11, 1973), Judge Timbers, joined by two other members of the Court, ignored his formulation in the instant action, and held that a charge to a jury that "in substance charged actual knowledge of falsity or reckless disregard for the truth . . . was essentially

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* Once the element of proof of *scienter* is eliminated, plaintiffs with claims concerning registration statements no longer will commence their actions under the 1933 Act with its statutory limitations, but will bring their actions under the almost limitless scope of the so-called anti-fraud provisions of the 1934 Act, and the complementary statutory scheme of the federal securities laws, intended by Congress, will be defeated. Under the 1933 Act, no improper motive must be established by a plaintiff in order to recover, but those persons who may sue, the time within which a suit must be commenced, and the measure of damages are strictly limited. 1933 Act §§ 11, 12 and 13, 15 U.S.C. §§ 77k, 77l, and 77m. See, generally, *Trussell* v. *United Underwriters, Ltd.*, 228 F.Supp. 75-7 (D. Col. 1964), and *Weber* v. *CMP Corporation*, 242 F.Supp. 321 (S.D.N.Y. 1965).

correct" in conveying the *scienter* standard. (¶ 93,937 at p. 93,734)

Then two weeks later, the Second Circuit, *en banc*, decided *Lanza* v. *Drexel & Co.*, CCH Fed Sec. L. Rep. [Current Binder] ¶ 93,959 (2d Cir. April 26, 1973). In *Lanza*, the majority of the Court, per Judge Friendly, held that " 'facts amounting to *scienter*, intent to defraud, reckless disregard for the truth, or knowing use of a devise, scheme or artifice to defraud' are essential to the imposition of liability" under Rule 10b-5. (¶ 93,959 at p. 93,828). However Judge Timbers in a vigorous dissent reiterated his version of the applicable rule as he did in the instant action, that a defendant is liable if it is shown that he knew or should have known the facts without proof of knowledge of falsity. (¶93,959 at pp. 93,843-4)*

The apparent continuing displeasure of certain of the members of the Second Circuit with the implications of too broad a standard with respect to culpability is further suggested by Judge Friendly's footnoted recognition in *Gerstle* v. *Gamble-Skogmo, Inc.*, CCH Fed. Sec. L. Rep. [Current Binder] ¶ 93,983 (2d Cir. May 9, 1973), that, although the Second Circuit "has on occasion phrased the test of scienter in terms of whether the defendant had knowledge of the facts that were omitted or misstated . . . such a test . . . would result in virtually absolute liability . . . ." (¶93,983 at p. 93,942 n. 20)

Thus, there is no clearly defined standard of proof within the Second Circuit for actions under the anti-fraud provision of the 1934 Act, and the three opinions in this case, as well as the subsequent decisions, only confuse the issue further. Of even greater importance to the proper administration of the federal securities laws, there is widespread divergence among the various Circuits as to what

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* Judge Timbers also joined in the dissenting opinion of Judge Hays, which expressly proposed the adoption of a negligence standard. (¶ 93,959 at p. 93,842)

scienter requirement, if any, must be met in a private damage action under the anti-fraud provisions.*

The chronology of changing standards of culpability under Rule 10b-5 is illustrated by the chart appended to Judge Adams' concurring and dissenting opinion in *Kohn* v. *American Metal Climax, Inc.*, 458 F.2d 255 (3d Cir. 1972), *cert. denied*, 409 U.S. 874 (1972). This thorough review of the case law forces concurrence with the learned judge's conclusion "that in every case where liability was found, conduct tantamount to actual fraud existed, despite the fact that the reviewing court may have used language broader than necessary." 458 F.2d 255, 286. Yet the language of the cases themselves cannot be ignored.

Decisions in the Seventh, Eighth and Tenth Circuits set forth a negligence standard. See: *Kohler* v. *Kohler Co.*, 319 F.2d 634, 637 (7th Cir. 1963); *Dasho* v. *Susquehanna Corporation*, 461 F.2d 11, 29 n. 45 (7th Cir. 1972), *cert. denied*, 408 U.S. 925 (1972); *Myzel* v. *Fields*, 386 F.2d 718, 734-5 (8th Cir. 1967), *cert denied*, 390 U.S. 951 (1968); *Vanderboom* v. *Sexton*, 422 F.2d 1233, 1238 (8th Cir. 1970), *cert. denied*, 400 U.S. 852 (1970); *Stevens* v. *Vowell*, 343 F.2d 374, 379-380 (10th Cir. 1965); *Mitchell* v. *Texas Gulf Sulphur*, 466 F.2d 90, 97 (10th Cir. 1971), *cert. denied*, 404 U.S. 1004 (1971).

Decisions in the Ninth Circuit indicate that liability is absolute upon a showing of a material misstatement or omission. See: *Ellis* v. *Carter*, 291 F.2d 270, 274 (9th Cir. 1961); *Royal Air Properties, Inc.* v. *Smith*, 312 F.2d 210, 212 (9th Cir. 1962).

The First, Third and Sixth Circuits appear to follow the strict standards initially laid down in the Second Circuit. See: *Rogen* v. *Ilikon Corp.*, 361 F.2d 260 (1st Cir.

* When this divergence among the Circuits is coupled with the broad jurisdiction and venue provisions contained in Section 27 of the 1934 Act, 15 U.S.C. § 78aa, the opportunities for "forum shopping" become apparent.

1966); *Kohn* v. *American Metal Climax, Inc., supra; Mader* v. *Armel,* CCH Fed. Sec. L. Rep. [1970-1971 Transfer Binder] ¶ 93,027 at 90,798 (S.D. Ohio 1971), aff'd without consideration of this point, 461 F.2d 1123 (6th Cir. 1972); *Golob* v. *Nauman, Vandervoort, Inc.,* CCH Fed. Sec. L. Rep. [Current Binder] ¶ 93,979 (N.D. Ohio July 1972).

The Fourth Circuit has not yet enunciated its *scienter* standard, and there is a conflict in the decisions of the District Court of Maryland. Compare *Batchelor* v. *Legg & Co.,* 52 F.R.D., 545, 548 (D. Md. 1971), and *John Hopkins University* v. *Hutton,* 326 F.Supp. 250, 255-7 (D. Md. 1971).

The standard in the Fifth Circuit is unclear. See: *Herpich* v. *Wallace,* 430 F.2d 792 (5th Cir. 1970), and *Clement A. Evans & Co.* v. *McAlpine,* 434 F.2d 100 (5th Cir. 1970). *Cf. Gold* v. *DCL, Incorporated,* CCH Fed. Sec. L. Rep. [Current Binder] ¶ 94,036 (5th Cir. June 29, 1973).

From the foregoing, it is obvious that there is total confusion on an issue of law which is vital to a mushrooming source of time-consuming and expensive lawsuits, which are rapidly burying the district courts in a sea of litigation. Corporations, their executives and directors are exposed to claims involving millions of dollars of damages, as in the instant case, and yet their legal counsel are without the tools necessary to give reliable legal advice as to whether their actions are unlawful or not. It is a matter of great importance to the business community and of pressing need to the federal judiciary that this Court resolve the continuing conflict among the Circuits on the question of proof of *scienter* under the anti-fraud provisions of the 1934 Act.

B. The Second Circuit's decision herein has effectively eliminated proof of causation in all private actions under the 1934 Act based upon an erroneous interpretation of this Court's prior decisions.

The decision of the Second Circuit herein represents a radical extension of this Court's recent decisions in *Mills*

v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970), and *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972). From the presumption of reliance which was established by this Court in *Mills* and *Ute*—cases involving direct dealings between a large group of plaintiffs and a defendant where the injuries claimed were logically tied to clear violations of the anti-fraud provisions of the 1934 Act and obvious practical difficulties in presenting proof of causation existed—the Second Circuit has created an irrebuttable presumption of causation of injury in favor of a single corporate plaintiff who was not even a party to the transactions in which the alleged violations of the anti-fraud provisions of the 1934 Act occurred. This irrebuttable presumption was created despite the specific finding by the Trial Court, expressly accepted by the Court below, that CCI did "not establish a nexus between the violations it charges and the damages it claims to have suffered" (Jt. App. G-23) and "that CCI failed to show with reasonable certainty that it would have obtained a controlling position in Piper had it not been for the [defendants'] violations of the securities laws . . ." (Jt. App. H-56).

Thus, based upon its interpretation of this Court's prior decisions, the Second Circuit effectively abolished both the traditional tort principle of proximate causation and the express statutory requirement in Section 28(a) of the 1934 Act, 15 U.S.C. § 78bb(a), that damages be limited to the "actual damages [sustained] on account of the act complained of", for all actions involving violations of the 1934 Act. Before such an extension of the principles laid down in the *Mills* and *Ute* decisions becomes accepted law in federal securities cases and the statutory mandate ignored, this Court should fully consider this vitally important question and the implications of the violent departure from traditional legal principles of proof.

The Court below held that despite the failure of proof that any of the violations of the 1934 Act in fact prevented

CCI from obtaining control of Piper, CCI was nonetheless entitled to prove its claim for millions of dollars of alleged damages because BPC would not have control of Piper if, from its present Piper holdings (52%) were deducted the two blocks of Piper shares (14%) found to have been improperly acquired. In other words, the arithmetic fact that BPC would not have more than 50% of the Piper shares now, if it was deprived of the two blocks, is irrebuttable proof that BPC's acts caused CCI its claimed injury.*

This simplistic formulation ignored the determination of the District Court that CCI's failure resulted from its inability or unwillingness to pay the requisite price for victory. (Jt. App. G-16). With respect to the block of Piper shares acquired by BPC in violation of Section 14(e) of the 1934 Act, the Second Circuit, expressly relying on the *Mills* and *Ute* decisions, held despite the absence of any evidence that CCI would have obtained even one additional share had the violation not occurred, that as a matter of law the violation caused CCI's injury. (Jt. App. H-59-60, 95, 110). With respect to the block of Piper shares acquired by BPC in transactions held to be in violation of Rule 10b-6, a majority of the panel (Judges Gurfein and Mansfield) recognized that no Piper shareholders were deceived by such purchases. (Jt. App. H-96, 111). The Court held, however, that the mere fact that such purchases were found to have been made in violation of Rule 10b-6 established

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* The Second Circuit, in addition to awarding CCI money damages because it did not obtain control of Piper, directed the District Court to enter a decree barring BPC from voting the Piper shares (14%) involved for a period of at least five years. (Jt. App. H-69). The effect of such a decree would be to give CCI, the present holder of 42% of the Piper shares, the power to control the operating affairs of Piper. In other words, the Second Circuit has on the one hand indemnified CCI for its alleged loss by awarding money damages on a novel principle of law, and, then on the other, used the equitable powers of the federal courts to attempt to revise the results of the take-over contest, at least for a period of five years.

causation of CCI's injury as a matter of law.* (Jt. App. H-66-67, 96, 111).

In sum, the Second Circuit held that the mere existence of a violation of the 1934 Act established causation in fact as a matter of law.** Such a presumption finds no support in *Mills* and *Ute*.*** (Jt. App. G-20-23).

The implications of this decision are obvious and far reaching. Private actions under the anti-fraud provisions of the 1934 Act are complicated and time-consuming, and are probably the single largest cause of the congestion in the federal trial courts today. To expand the scope of

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* The fundamental fallacy in the Second Circuit's decision on this issue is that the purchases by BPC of the Piper shares for cash in May, 1969 did not violate Rule 10b-6. BPC submits that the opinions of District Judge Tenney (Jt. App. A-1-17) and Chief Judge Lumbard (Jt. App. B-21-31) and Circuit Judge Moore (Jt. App. B-18-20) were correct, and no violation of Rule 10b-6 occurred. This cause of action should have been dismissed as a matter of law. In any event, however, CCI failed to prove they would have obtained a single one of the 120,000 Piper shares involved. In fact, BPC offered uncontroverted proof that approximately 80,000 of the Piper shares purchased by it had first been offered to, and refused by CCI. (Jt. App. H-115).

** The incontrovertible fact is that on August 4, 1969 when BPC's and CCI's exchange offers to the Piper shareholders both expired, and all violations of the 1934 Act ended, BPC had approximately 45% of the Piper shares and CCI had approximately 41% of such shares. Control of Piper was available in the marketplace. BPC then outbid CCI in the public market for the available Piper shares, and by early September, 1969 had acquired more than 50% of all Piper shares to CCI's approximately 42%. (Jt. App. H-18). Although CCI had contended that BPC should be enjoined from purchasing control of Piper, the Second Circuit held that BPC was legally free to do so. (Jt. App. B-9).

*** The evidence presented at trial established clearly that CCI had ample opportunity during the eight months that it sought control of Piper to achieve its goal but that it failed to do so because it either lacked the necessary resources or was unwilling to pay the requisite price. The true cause of CCI's failure to obtain more than 50% of the Piper shares was that BPC paid an average of $17 per Piper share more than CCI paid to the Piper shareholders.

liability to include actions where bad faith is absent and, then, to eliminate the requirement that a plaintiff prove that his damages were *in fact caused* by the defendant* is to open the floodgates.

Under the decision below, once a defendant is found to have violated the 1934 Act, anyone who can come within the almost all-encompassing reaches of its provisions will be a possible plaintiff for an action in the federal court. No longer will he have to show that the defendant's acts injured him, but just that he has standing under one of the provisions of the 1934 Act to maintain an action and that the security he owns is worth less now than before the alleged violation of the 1934 Act. With respect to takeover contests, a defeated contestant, with the benefit of twenty-twenty hindsight, will merely need to persuade a court that the successful contestant violated some statutory provision or regulation of the 1934 Act during the course of the contest. It is difficult to envision even one contest for control in which, under the careful scrutiny of imaginative attorneys, such a showing could not be made.**

If corporations and their individual officers and directors are to be held personally liable for virtually unlimited damages under such circumstances, based upon an asserted interpretation of this Court's decisions in *Mills* and *Ute*,

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* See, e.g., *Milwaukee & St. Paul Railway Co.* v. *Kellogg*, 94 U.S. 469, 473-475 (1876); *Baird* v. *Franklin*, 141 F.2d 238, 239 (2d Cir. 1944); *Richardson* v. *Gregory*, 281 F.2d 626, 629 (D.C. Cir. 1960); and *Brennan* v. *Midwestern United Life Insurance Co.*, 286 F.Supp. 702, 725 (N.D. Ind. 1968), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970).

** In this connection, Judge Friendly in *Electronic Specialty Co.* v. *International Controls Corp.*, 409 F.2d 937 (2d Cir. 1969), observed:

> "Probably there will no more be a perfect tender offer than a perfect trial. Congress intended to assure basic honesty and fair dealing, not to impose an unrealistic requirement of laboratory conditions. ..." 409 F.2d at 948.

such liability should first be carefully considered by this Court.

C. The determination that a tender offeror has standing under Section 14(e) to sue for money damages is contrary to the expressed intent of Congress in enacting the legislation, and conflicts with principles enunciated by this Court governing creation of implied rights of action.

The decision below is the first in which a Circuit Court has considered the question of whether Section 14(e) of the 1934 Act confers standing to sue for damages to a tender offeror,* as distinguished from the shareholders of the target company or the target company on behalf of its shareholders. (Jt. App. H-24-33). In holding that it does, the Second Circuit not only misinterpreted the statute, but ignored previous decisions of this Court governing and limiting the creation of implied rights of action. If the decision is permitted to stand, it will be precedent for opening the Federal courts to claimants and causes hitherto unrecognized, engulfing an already overburdened system with actions never contemplated by Congress.

Section 14(e) was added to the 1934 Act as part of a series of amendments enacted in 1968 to deal with cash tender offers, a technique that had become increasingly popular in the years immediately preceding enactment. The reports of the Congressional Committees which considered the legislation refer to the increasing use of cash tender offers, the fact that existing legislation did not require disclosure to investors of facts concerning the offerer, and the need to enact legislation which would require disclosure to shareholders. S. Rep. No. 550, 90th

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* The Second Circuit expressly did not consider CCI's claim under Rule 10b-5 because it sustained the claim under Section 14(e). However, CCI, not being a purchaser or seller of BPC securities, could not sustain a claim under Rule 10b-5. See *Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F.2d 963 (2d Cir. 1969), *cert. denied*, 399 U.S. 909 (1970).

Cong., 1st Sess. 1-3 (1967); H. Rep. No. 1711, 90th Cong., 2d Sess. 2-3 (1968). Section 14(e) was enacted as part of a series of amendments designed to fill the gap which had hitherto existed with respect to these offers.

The legislative history of the amendments gives abundant evidence that the class the legislation was designed to protect was the shareholders of the target corporation, and that Congress viewed tender offerors as being in essentially the same category as employers under the Safety Appliance Act—persons on whom obligations are imposed, but not part of the class for whose protection the legislation is enacted.* Indeed the entire thrust of the legislative history emphasizes the need for protection from, not protection for tender offerers. Thus the Senate report describes need for the legislation as follows:

> "[B]y using a cash tender offer the person seeking control can operate in almost complete secrecy. At present, the law does not even require that he disclose his identity, the source of his funds, who his associates are, or what he intends to do if he gains control of the corporation. As a practical matter, unless incumbent management explains its position publicly, the investor is severely limited in obtaining all of the facts on which to base a decision whether to accept or reject the tender offer.
>
> "The public shareholder must, therefore, with severely limited information, decide what course of action he should take.
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> * * * * *
>
> "Without knowledge of who the bidder is and what he plans to do, the shareholder cannot reach an informed

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* See discussion of *Texas & Pacific Ry.* v. *Rigsby*, 241 U.S. 33 (1916), and *Crane* v. *Cedar Rapids & ICR Co.*, 395 U.S. 164 (1968), *infra*.

> decision. He is forced to take a chance. For no matter what he does, he does it without adequate information to enable him to decide rationally what is the best possible course of action.
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> * * * * *
>
> "This bill is designed to make the relevant facts known so that shareholders have a fair opportunity to make their decision." S. Rep. No. 550, 90th Cong., 1st Sess. 2-3 (1967).

This view is also evident in the section of the Committee Reports explaining Section 14(e), in which the object of the Section is stated as that of obliging the protagonists to make full disclosure "to those with whom they deal" i.e., the target shareholders:

> "This provision would affirm the fact that persons engaged in making or opposing tender offers or otherwise seeking to influence the decision of investors or the outcome of the tender offer are under an obligation to make full disclosure of material information to those with whom they deal." S. Rep. No. 550, 90th Cong., 1st Sess. 11 (1967); H. Rep. No. 1711, 90th Cong., 2d Sess. 11 (1968).

That the investors whom Congress sought to protect were the shareholders of the target corporation and not the offerors is further evidenced by a reference in the section of the Committee Reports entitled "Protection of Investors." The Committee Reports state that the legislation is needed to protect investors "caught in the midst of a battle for corporate control." S. Rep. No. 550, 90th Cong., 1st Sess. 4 (1967); H. Rep. No. 1711, 90th Cong., 2d Sess. 4 (1968).

The hearings which preceded the Committee Reports confirm that the concern of Congress was the shareholders of the target corporation. Throughout the hearings, wit-

nesses and legislators stated the need for protecting the target shareholders, and the single witness who addressed himself to the subject specifically stated that the offeror did not need protection. Testifying before the Senate Committee, Professor Samuel Hayes, III, of the Columbia Business School said:

> "The two major protagonists—the bidder and the defending management—do not need any additional protection in our opinion. They have the resources and arsenal of moves and counter moves which can adequately protect their interests. Rather, the investor —who is the subject of intrigues of both major protagonists—is the one who needs a more effective champion and this is an important point." Hearing on S. 510 Before Subcom. of Securities of the Senate Committee on Banking and Currency, 90th Cong., 1st Sess. 57 (1967).

The Court below did not question that the class for which legislation was designed was the shareholders of the target corporation. Judge Timbers specifically conceded this fact, noting that "[T]he legislative history of the 1968 amendment demonstrates that the focus of legislative interest was on the public shareholder; Congress wanted to ensure that he had the benefit of a full statement from the offerer with a charge for 'incumbent management' to 'explain its position' if so [illegible]." (Jt. App. II-31-32)

Despite the absence of support in the statute, each judge below held that standing existed on different grounds. Judge Timbers held that CCI had standing under "common law tort principles" (Jt. App. II-30-31). However his rationalization is patently unsound and was completely ignored by the other two judges. Judge Gurfein proceeded on a different theory, making no reference to the statute or the tort theory of Judge Timbers, and held that standing was solely a question of causation and causation was presumed as a

matter of law because of the materiality of the omission. (Jt. App. H-95). Judge Mansfield eschewed both the above rationalizations (although similarly ignoring the statute), holding standing existed solely on the ground that "vigorous enforcement of the anti-fraud provisions through private litigation" required it. (Jt. App. H-102-103).

The confusion evidenced by the three separate opinions would alone justify review. More significantly, however, the total disregard of the essential fact that tender offerors are not a class for whose protection the statute was enacted, makes the decision a new departure, and one in conflict with principles enunciated by this Court.

Since *Texas & Pacific Ry.* v. *Rigsby*, 241 U.S. 33 (1916), American courts have recognized that private rights of action may be implied from statutes which do not specifically provide therefor. Until the present case, however, the courts have recognized the express limitation laid down in *Rigsby*, viz.: that rights of action may be implied in favor of a particular plaintiff only if he is "one of the class for whose especial benefit the statute was enacted". 241 U.S. at 39.

The requirement that a plaintiff be a member of the class for whose special benefit legislation is enacted is central to the doctrine of implied rights of action enunciated in *Rigsby*. Beginning with the common law maxim *Ubi jus ibi remedium*, the Court reasoned that a statute enacted to benefit a particular class accorded a right to that class, and that the quoted maxim mandated a remedy. The Court enunciated the principle as follows:

> "A disregard of the command of the statute is a wrongful act, and where it results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is implied, according to a doctrine of the common law expressed in 1 Com. Dig., *tit.* Action upon Statute (F), in these words: 'So, in every case, where a

> statute enacts, or prohibits a thing for the benefit of a person, he shall have a remedy upon the same statute for the thing enacted for his advantage, or for the recompense of a wrong done to him contrary to the said law.' (*Per* Holt, C.J. *Anon.*, 6 Mod. 26, 27.) This is but an application of the maxim, *Ubi jus ibi remedium.*" (citations omitted). 241 U.S. at 39-40.

The limitation laid down in *Rigsby* has been recognized in securities cases. In *Greater Iowa Corp.* v. *McLendon*, 378 F.2d 783 (8th Cir. 1967), the Court denied standing under the 1933 Act and the 1934 Act to plaintiffs who were not purchasers of securities, on the ground that non-purchasers were not members of the class the legislation was designed to protect. The Court said:

> "However, a breach of statutory duty does not give rise to a private cause of action to every person injured by the statutory breach. The law clearly demands that the statutory breach must cause injury to one of the class that the statute is designed to protect." 378 F.2d at 790.

This Court's decision in *J. I. Case* v. *Borak*, 377 U.S. 426 (1964), is not precedent for disregarding the foregoing limitation. In *Borak*, the question was whether *any* private right of action could be implied, and consistent with the rule that private rights of action can be implied in favor of those whom a statute is designed to protect, the Court held that the shareholders who were the objects of proxy solicitations could sue for violations of the proxy rules.

The question in the instant action is different. Unlike *Borak*, the question is not whether any private relief shall be available; all agree that under *Borak* a private right of action is implied in favor of the Piper shareholders. Rather the question is *to whom* a private remedy is to be given, and specifically whether a *second* class—a class viewed by Congress as antagonistic to the protected class—should also be

accorded standing to sue under the statute. It is submitted that nothing in *Borak* or the prior decisions of this Court justifies such a result.

Where, as here, Congress has enacted a statute for the benefit of a particular class, the courts may not create a right of action in another class. This principle was specifically recognized in *Crane* v. *Cedar Rapids & ICR Co.*, 395 U.S. 164 (1968), where this Court refused (over the dissent of three judges who cited *Borak*) to accord standing under the Safety Appliance Act to non-employees. The Court stated that any anomalies must be resolved by Congressional amendment; a court may not rewrite the statute. 395 U.S. at 167.

The usurpation represented by the decision below is particularly unjustified in that the rights of the target shareholders who were the object of Congressional concern have been fully vindicated. In a companion case, *SEC* v. *Bangor Punta Corporation* (Jt. App. H-89-93), the Second Circuit affirmed a decision of the District Court (Jt. App. C-1-18) which ordered Bangor Punta to make an offer of rescission to all Piper shareholders who had accepted Bangor Punta's exchange offer. Thus, no judicial expansion is necessary to effectuate the Congressional purpose.

Nor is extension of standing to a new class required to provide the "private enforcement" referred to in *Borak* as a "necessary supplement to Commission action". 377 U.S. at 432. In addition to *SEC* v. *Bangor Punta, supra,* there are presently pending in the District Court for the Southern District of New York two class actions on behalf of Piper shareholders in which the Section 14(e) violations alleged herein are duplicated. Given the vigor of the plaintiff's bar, no new class of plaintiffs is necessary to ensure private actions under Section 14(e).

Beyond encroaching on the province of Congress, the decision below will create serious problems for the Judicial Branch. Congress has enacted countless regulatory

statutes, but until now the courts have restricted private actions to those for whose special benefit the statutes were designed. If the decision below is permitted to stand, it will signal that this important limitation has been discarded, and the inevitable result will be to add an entirely new source of lawsuits to an already overburdened Federal judiciary.

Conclusion

For the foregoing reasons, a writ of certiorari should issue to review the judgment and opinion of the Second Circuit.

Respectfully submitted,

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